

Memorandum

To: National Credit Union Administration
From: University Credit Union
Date: 04/06/09
Re: Response to the NCUA Advance Notice of Proposed Rulemaking (ANPR)

The NCUA ANPR speaks to the role of Corporate Credit Unions in the Credit Union System with six areas in question that NCUA believes have contributed to the issues we face today or may need to be addressed to prevent similar issues from happening in the future. Those six areas of concern are:

- Payment Systems Isolation
- Liquidity and Liquidity Management
- Investment Authorities and Risk
- Field of Membership/Two Tier Structure
- Corporate Capital
- Corporate Governance

Payment Systems Isolation

NCUA should not isolate the payments systems from other corporate services. This would increase expenses to the member credit unions on both the payment systems side and the investment side. We are all aware that we have products that are unprofitable on their own yet these products are necessary and are supported by other products within the institution. The same thing would happen if the Corporate Credit Union system separated the various functions into separate entities. Both the payments systems and the investment services are needed by many credit unions and separating the two into individual entities would only increase the costs to the member credit unions. Keeping all services under one corporate achieves economies of scales with payment system services as well as with all other services.

NCUA's issue here is the liquidity risk and the possibility of not funding settlements. A separate entity would not address the liquidity issues here and may, in fact, have a negative effect on liquidity. You still need the funds from the Corporate Credit Union to fund the liquidity and if these were separated, then you have the additional step of transferring funds from the member credit union's account at the Corporate to the payment systems entity. This will increase both the liquidity risk and the operational risk as the additional step allows for more errors to occur. In addition, these institutions can establish specific operating guidelines to effectively place a wall between the various services.

Liquidity and Liquidity Management

Liquidity is a core service of a Corporate Credit Union. In fact, their original purpose was to provide and ensure liquidity. Investments were made keeping in mind the liquidity needs of the member credit unions. The question here is not whether liquidity is a core service, because it is, but how to preserve and strengthen their ability to offer this service. Here are some ideas:

- Corporate Credit Unions need access to the Central Liquidity Fund. Reliance on one source for liquidity such as US Central provides a huge concentration of risk. Corporates should have a diversified pool of resources for liquidity.
- Limit (don't eliminate) the ability of Corporate Credit Unions to borrow for purchasing investments for leverage.
- Impose minimum liquidity requirements on the Corporate Credit Unions.
- Require additional interest-rate sensitivity testing.
- Adequate measurement and reporting processes are also needed to effectively manage liquidity.

Investment Authorities and Risk

Corporate Credit Unions need to have the ability to invest their funds both in the short term and the long term. As they are aggregators and serve a number of natural person credit unions, they need investment authorities beyond what is granted to natural person credit unions. Expanded authorities require complex infrastructures, allow for broader risk mitigation, permit accelerated capital accumulation and should be based on on-going regulatory qualifications. To assist in this, Corporate Credit Unions should not solely rely on rating agencies. They also need to utilize more robust risk-mitigation tools. They also need a risk-based capital approach and must be capable of the modeling and analyses needed to anticipate measure and monitor the risk involved.

Obviously, this requires a more sophisticated level of expertise both at the Corporate Credit Union and at NCUA as well. NCUA could impose specific educational and experience requirements on those at the Corporate Credit Unions involved in the investment services. NCUA also needs to impose the same requirements on the NCUA and State Examiners in order to examine Corporate Credit Unions with expanded investment authorities.

In addition, the greater the authorities, the greater the capital requirements should be. Each Corporate Credit Union with expanded authorities needs to recertify on an annual basis.

Field of Membership/Two-tier Structure

Corporate Credit Unions are an integral part of the credit union system and we should not ever do away with them. However, we currently have too many Corporate Credit Unions. We do not need 28 yet we do need a network of about 8 – 10 across the nation. We should continue to allow Corporate Credit Unions to have national fields of membership. This gives natural person credit unions plenty of options within the credit union network. It also creates healthy competition among the Corporate

Credit Unions and prevents a monopoly – whether across the entire country for a Central or in a region for a regional.

Increased competition does lead to higher risks. But risks are there whether you have a national or a regional field of membership. The key is recognizing, measuring, monitoring and mitigating these risks. Increased competition has also led to better rates for natural person credit unions.

Corporate Credit Unions need to recognize that while they are in competition with each other, they can still share knowledge and leverage resources to meet the needs of the natural person credit unions. This will help widen margins and accumulate capital. Competition is generally a productive force and this combined with increased cooperation among the Corporate Credit Unions will produce a greater value to all credit unions and their members.

Limited fields of membership, as seen in the FHLB System, have not eliminated the economic stresses we are seeing today. However, if fields of memberships are limited in the future, each natural person credit union must be allowed to pick their Corporate Credit Union, regardless of its location. This decision should not be based solely on geographic locations.

The current two-tier system does have its inefficiencies and concentrations of risk. It is unnecessary to have a Central Credit Union for the Corporates at the top. A system of 8 – 10 regional Credit Unions will function quite well as the Federal Reserve System does.

Corporate Capital

NCUA needs to consider a risk-based capital structure for Corporate Credit Unions, comparable to other types of depository institutions. Right now, parties outside the credit union industry do not understand the Corporate Credit Union system. We also need higher minimum capital ratios for both retained earnings and capital. However, if we change the capital levels, we must also have the same levels of authority or we will be going down the road of underperformance and disintermediation. The risk weighting process must also be re-evaluated. It currently looks at credit risk, but we all know that today's problems are largely a result of liquidity risk. This needs to be re-evaluated to include other risk factors.

Any timeline needs to be aware the current economic conditions and give the corporate Credit Unions time to meet any new requirements.

Corporate Credit Unions should not limit services to only those with who maintain capital (members) at that particular corporate. This will limit competition. They can, however, have different pricing for members versus non-members.

Corporate Governance

Corporate Governance needs to be reviewed and not left as is. This did contribute, in a small part, to the existing problems in the system. NCUA needs to require specific director qualifications and impose training requirements (both initial and ongoing) and these need to be standardized across the nation. The qualifications should be commensurate with the complexity of the institution. Reasonable term limits are also necessary as long as they are not overly restrictive but these should be determined by the individual Corporate Credit Union and not by the regulator.

Corporate Credit Union directors should not be compensated. That goes against the entire philosophy of the Credit Union industry.

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Directors for each Corporate Credit Union should be a mix of Executive Officers from credit unions served by the Corporate as well as those from credit unions not served by the corporate. Directors can also include retired Executives, those associated with Leagues and other Credit Union trade groups. However, the outside directors and others should not outnumber those CEO's who are served by the Corporate Credit Union.

Disclosure of executive compensation at the Corporates should be the same as it is for natural person credit unions which are an employment contract between the Board and the CEO. NCUA already has the authority to inspect and monitor compensation for all credit union and corporate credit union employees. Making this public does absolutely nothing to address the issues we are facing today.

Conclusion

The Corporate Credit Union system has served the Credit Union industry well over time. It does need to be reviewed and necessary changes made, but it is an important part of this industry and must continue in the future. There are Corporate Credit Unions today that are performing well and there are those that are not. We can learn a great deal from both and apply that knowledge to the future to help avoid a repeat of today's situation. We at University Credit Union are very dependant upon our Corporate as our primary provider of many services: payment, investment and liquidity to name a few. We also have investments at two other Corporates and that has helped us achieve positive growth and solid capital. The events that have taken place recently underscore the need to review the system thoroughly and make necessary adjustments.

The other issue that needs to be addressed is the need for much better oversight by the NCUA at the Corporate Credit Union level – and, to a degree – at the natural person credit union level. This will include higher levels of training and expertise for all NCUA and State Examiners. It may also mean a more stringent exam schedule. It will also require NCUA to be held accountable when they do not perform their duties as they should.

Whatever direction the NCUA takes in restructuring the Corporate Credit Union System, it will certainly have a different look and feel than the one today. While we are in this process, it is important to understand that neither the NCUA nor the Corporate Credit Unions are solely responsible for the problems we are facing. This is a widespread issue with many places to place blame. It took us a while to get to this point and it will take longer to come out of it. Any changes made to the Corporate Credit Union system must be made keeping the current economic environment in mind and must not be a knee-jerk reaction. Any decisions must be made keeping the past, the present and the future of this industry in mind.

Sincerely,

The Senior Management Team of University Credit Union